IN THE

Supreme Court of the United States

October Term, 1962.

No. 339

HENRIETTA O. MURDOCH,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT AS OF NO. 14,223.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT AS OF NO. 14,223.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The Petition of Henrietta O. Murdoch respectfully represents:

REPORTS OF COURTS BELOW.

The opinion of the Court of Appeals for the Third Circuit is not as yet officially reported. It is printed in this petition (p. 12).

The memorandum findings of fact and opinion of the Tax Court are not officially reported. It is printed in the petitioner's appendix in the Court of Appeals (pp. 2a-12a). It is unofficially reported as "John H. Murdoch, T. C. Memo. 1962-196, CCH 1962."

JURISDICTIONAL GROUNDS.

(i) On June 7, 1963, the United States Court of Appeals for the Third Circuit, on petition to review a decision of the Tax Court of the United States, entered a judgment affirming the decision of the Tax Court.

(ii) On July 8, 1963, the Court of Appeals entered an order denying a petition for rehearing of said case.

(iii) The jurisdiction of your Honorable Court is invoked under the Act of June 25, 1948, Chapter 646, 62 Stat. 928 (28 U. S. C. A. 1254).

QUESTIONS PRESENTED.

1. Is the classification for tax purposes the nature and basis of the action settled; or does it turn on the form of the action and the phrasing of the settlement instrument?

2. How can a stockholder get income from another stockholder?

3. Upon the transfer of stock for cash, can the consideration be split into principal and income—the latter deductible by the purchaser and ordinary income to the seller?

STATUTE INVOLVED.

The statute involved is the *Internal Revenue Code of 1954, Section 1221*, the pertinent text of which reads:

> "Capital Asset defined. For purposes of this subtitle, the term 'capital asset' means property held by the taxpayer (whether or not connected with his trade or business), but does not include ——
>
> "(1) Stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."

STATEMENT OF THE CASE.

The Court of Appeals for the Third Circuit affirmed a decision of the Tax Court that out of $36,500 received by your petitioner from her brother-in-law in settlement of a suit for shares of stock of which he had defrauded her the sum of $16,500 was ordinary income to her; and that he could deduct the $16,500 plus attorney's fees of $3,582.30 from his income. The Commissioner of Internal Revenue to this date agrees.

The widow Murdoch (your petitioner) owned stock.

Her brother-in-law got it from her.

She entered suit against her brother-in-law alleging he obtained title by fraud. She asked for financial information—an accounting.

The case was settled for $36,500, which he paid.

The settlement was split: $20,000 for the property with which he deceived her (which was stock in a phony corporation), and $16,500 for a general release of her brother-in-law and the corporations.

Her title ceased (assuming the settlement was fair).

She reported the entire $36,500 as capital gain on her original investment.

He deducted the $16,500 plus $3,582.30 ($20,082.30) as an expense.

In the statutory notice of deficiency (90 day letter) the Commissioner of Internal Revenue took an inconsistent position; i.e., he taxed the $16,500 to the widow as ordinary income (tax due $4,912.51); and he denied the deduction of $16,500 plus $3,582.30 attorney's fees to the brother-in-law (tax due $9,709.99).

In his brief to the Tax Court, the Commissioner sided with the brother-in-law.

The Tax Court and the Court of Appeals agreed with the brother-in-law and the Commissioner, on the ground that the widow's lawsuit asked for income from the brother-in-law. They quoted the prayers of her complaint.

However, both Courts found as a fact that the gravamen of her complaint was solely the fraud which deprived her of her stock.

As a matter of fact, the quoted prayers of the widow's complaint do not ask for income from her brother-in-law.

They ask only for financial information.

The widow loses $4,912.51.

The United States loses $4,797.48.

The brother-in-law saves $9,709.99.

JURISDICTION OF COURT OF FIRST INSTANCE.

Within ninety days of the issuance of a notice of deficiency by the Commissioner under Section 6212 of the Internal Revenue Code of 1954, the widow petitioned the Tax Court for a redetermination under Section 6213 of said Code.

The decision of the Tax Court was reviewed by the United States Court of Appeals for the Third Circuit under Section 7482 of said Code.

ARGUMENT FOR PETITIONER.

The Court of Appeals correctly states the facts.

An analogy will show how it reaches an erroneous conclusion: It finds as a fact, that the horse is white. Therefore, because the horse is black it is hard to see in the dark!

The Tax Court did the same thing. In my brief in the Court of Appeals, I characterized the statement of the Tax Court as "confused."

The widow's claim was for one thing—*and one thing only.*—as stated by the Court of Appeals:

> ". . . she charged him with having fraudently induced her to exchange her 49% interest in the stock of the John P. Murdoch Company for 49% of the shares of the stock of 3630 Haverford Avenue Corporation; . . ."

which was formed with only *part of the assets* of the Murdoch Company.

The first case cited by the Court of Appeals is *Carter's Estate v. C. I. R.*, 298 F. 2d 192 (8 Cir. 1962), cert. denied 370 U. S. 910 (1962), which case cited and relied upon *Raytheon Production Corp. v. Comm.*, 144 F. 2d 110, and we now quote from page 113:

> "The allegations and evidence as to the amount of profits were necessary in order to establish the value of the good will and business since that is derived by a capitalization of profits." * * * "Since the suit was to recover damages for the destruction of the business and the good will, the recovery represents a return of capital. Nor does the fact that the suit ended in a compromise settlement change the nature of the recovery; **'the determining factor is the nature of the**

> **basic claim**, from which the compromised amount was realized.' "

We agree with, *and rely on*, these cases.

In the *prayer* of her complaint, the widow asked for financial information—for **an accounting.** She had a right to know—the value of what she had been defrauded.

The Tax Court wrote (11a):

> "The main thrust of her complaint was an accounting from John in respect to profits to which she, *somehow or other*, claimed to be entitled." (Italics supplied.)

That just **is not so.** The **only** thrust of her complaint was that her brother-in-law:

> "fraudulently induced her to exchange her 49% interest in the stock of the John P. Murdoch Company for 49% of the shares of the stock of the 3630 Haverford Avenue Corporation;"

and the astonishing thing, apparent to any note editor of a law review, is that after stating this fact *and quoting verbatim her prayer* for an accounting and financial information the Court of Appeals concludes that $16,500 of the $36,500

> "was in settlement of her demand upon Mr. Murdoch to account to her for **profits to which she claimed to be entitled.**"

She made no claim *for the profits.*

She did not claim to be entitled to *any profits from John P. Murdoch, Jr.*

She had *no legal basis for a claim to the profits.*

She had one claim, *and one claim only*, against John P. Murdoch, Jr., and that was for stock of the John P. Murdoch Company—**and so says the Tax Court and the Court of Appeals.**

The law of the land determines her rights. Her only right against her brother-in-law was a capital right. If the case had gone to trial and she had prevailed, he would have returned to her the stock of the John P. Murdoch Company.

I know of no rights a stockholder has as such against another stockholder.

Unless the law of corporations is to be re-written, a stockholder's rights against a corporation are for dividends, when declared out of profits. The tax returns (25a) show *no dividends were ever paid* by the John P. Murdoch Company.

The division of the settlement money of $36,500 into two funds was a tax dodge pure and simple. The inexplicable position of the Commissioner seems like some sort of death wish.

The splitting of the $36,500 into two amounts of $20,000 and $16,500 was a fraud upon a fraud. So far, by it John P. Murdoch, Jr., has obtained a deduction of $16,500 plus attorney's fees of $3,582.30. This is contrary to all the decided cases, including those cited by the Court of Appeals and the recent cases of *U. S. v. Gilmore*, 372 U. S. 39, 44 (1963):

> "* * * 'conservation of property' seems to refer to operations performed with respect to the property itself, such as safeguarding or upkeep, rather than to a taxpayer's retention of ownership in it."

and *U. S. v. Patrick*, 372 U. S. 53, 57 (1963):

> "It would be unsound to make deductibility turn on the nature of the measures taken to forestall a claim rather than the source of the claim itself."

Sequential thought shows that this case as decided by the Court of Appeals changes "well settled law" and opens a loop-hole in the tax law. By acquiescing in the decision of the Court of Appeals the Commissioner of Internal Revenue has stamped with approval a tax evasion scheme. This case, important as it is to the widow Murdoch, may not involve a large amount compared to the fraud case involving 60,000 shares of Pepsi-Cola at $140 a share mentioned in the financial section of the New York Times July 14, 1963.

We need look no further than the very cases cited by the Court of Appeals:

> "It is well settled law that the classification for tax purposes of amounts received in litigation is to be determined by the **nature** and **basis** of the action settled." *Carter's Estate v. C. I. R.*, 298 F. 2d 192, 194.

> "Petitioners rely entirely on the **form of the settlement instrument**—an instrument of assignment rather than a release." *Estate of J. T. Longino*, 32 T. C. 904.

What was once "well settled law" has now become unsettled. The "nature and basis"—**the gravamen**—is no longer the determining factor, but the "prayers for relief" and the "form of the settlement instrument" now classify for tax purposes in the Third Circuit—with the acquiescence of the Commissioner of Internal Revenue. Open wide the doors!

The fraud was set up with the guidance of Harry J. Alker, Jr. (see Record p. 24a), who must now be chortling!

A swindler has saved $9,709.99, the widow has been hit with $4,912.51 and the United States has lost the difference of $4,797.48.

It is an interesting coincidence that McBride, von Moschzisker & Bradley were representing the widow in the fraud action at the same time they were representing her brother-in-law's lawyer (cf. Tax Court's findings of fact, and *U. S. v. Alker*, 260 F. 2d 135, cert. denied 359 U. S. 906, rehearing denied 359 U. S. 950):

Wherefore your petitioner, Henrietta O. Murdoch, respectfully prays that a writ of certiorari be issued to the United States Court of Appeals for the Third Circuit so that the law again may be "well settled" and—as you phrased it in *U. S. v. Patrick, supra*, the "source of the claim" may again determine taxability and the amount thereof.

Respectfully submitted,

HENRIETTA O. MURDOCH,
Petitioner,
By: HENRY D. O'CONNOR,
Attorney for Petitioner.

OPINION OF THE COURT.

(Filed June 7, 1963.)

By FORMAN, Circuit Judge.

PETITION FOR REVIEW BY HENRIETTA O. MURDOCH, No. 14,223.

John P. Murdoch and his brother Eugene K. Murdoch, each owned 49% of the stock of John P. Murdoch Company, a business they inherited from their father. For some years prior to his death, in September of 1945, Eugene K. Murdoch was ill and John P. Murdoch managed the business. Eugene K. Murdoch continued to draw a salary until his death, at which time his widow, Henrietta C. Murdoch, inherited his interest. Shortly thereafter John P. Murdoch and Mrs. Murdoch agreed that the physical assets, viz.: the real estate and production equipment of the John P. Murdoch Company, at 3630 Haverford Avenue in Philadelphia, would be transferred to a new corporation in exchange for its stock, of which 49% would be issued to Mrs. Murdoch in place of her shares in the John P. Murdoch Company and 49% would be held by Mr. Murdoch. The new corporation was named the 3630 Haverford Avenue Corporation. On December 31, 1946 it leased the premises and equipment to the John P. Murdoch Company for $1,200 per year plus taxes and mortgage interest. This rental arrangement continued until April 1, 1955, when the rent was increased to $5,000 per year without the obligation of the lessor to pay taxes or interest. Meanwhile Mr. Murdoch had been paying Mrs. Murdoch twenty dollars per week which he reduced at this time to ten dollars.

In June 1955 Mrs. Murdoch instituted an equity action against her brother-in-law in which she charged him with having fraudulently induced her to exchange her 49% interest in the stock of the John P. Murdoch Company for 49% of the shares of the stock of 3630 Haverford Avenue Corporation; that the fair rental value of the property and machinery was $6,500 per year, and demanded:

"(a) . . . an accounting of all the profits made by him by virtue of his ownership of 50% of the stock of the John P. Murdoch Company since the 1st day of January, 1945.

"(b) 49% of the fair rental value of the real estate and machinery leased by the 3630 Haverford Avenue Corporation to the John P. Murdoch Company from December 31, 1946 until December 31, 1954.

"(c) A complete accounting of all transactions of the John P. Murdoch Company and the 3630 Haverford Avenue Corporation from the 1st of January, 1945 to date.

"(d) Such other and further relief as this court may deem appropriate in the premises."

The litigation was settled before trial on December 11, 1957, as a result of which Mrs. Murdoch executed two documents. One was designated a "Release" and provided, as consideration for the payment to her of $16,500 that she released John P. Murdoch from all claims including those encompassed in the equity action and as well released the John P. Murdoch Company and the 3630 Haverford Avenue Corporation from all claims. The other document was designated a "Bill of Sale" and provided that in consideration of the payment to her of $20,000 she assigned to Mr. Murdoch her stock in the 3630 Haverford Avenue Corpora-

tion. Two checks were made by Mr. Murdoch payable to her lawyers. One was for $16,500 and contained on its face the statement "Payment in release of all claims in suit of Murdoch v. Murdoch, C. P. I." The other was in the sum of $20,000 and was marked "Payment in full for 49% shares 3630 Haverford Ave. Corp. stock."

In her income tax return for the year 1957 Mrs. Murdoch reported the full amount of $36,500 received from Mr. Murdoch as proceeds of the sale of "John P. Murdoch Co." and the resulting gain as being long term capital gain. The Commissioner determined that $16,500 of the $36,500 payment was taxable as ordinary income.

The Tax Court sustained the position of the Commissioner.*

Mrs. Murdoch seeks a review of the determination of the Tax Court. She asserts that the entire payment of $36,500 to her was a "sale or exchange" of a capital asset within the meaning of §§ 1221 and 1222 of the Internal Revenue Code of 1954 and that no part of it was ordinary income to her.

The pith of her argument is that Mr. Murdoch fraudulently induced her to part with her stock in the Murdoch Company for an amount less than subsequent disclosure revealed the book value to be; that Mr. Murdoch, individually, owed her no duty to pay income on her interest in the Murdoch Company; that the only source to which she could look for income was the Murdoch Company by way of dividends and that she did not make the company a party to her suit. Under these circumstances she reasons that her suit was for the restoration of her stock in the Murdoch Company and that the aggregate sum of $36,500 which she recovered in the settlement represents value for that stock.

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* John P. Murdoch, T.C. Memo. 1962-196, 7 C.C.H. 1962, Stand. Fed. Tax Rep. ¶ 7615(M).

no part of which is susceptible of being characterized as ordinary income.

The Tax Court considered that the nature and basis of her law suit and its settlement were revealed in her complaint and the papers which documented the settlement. It held that, absent other evidence to import meaning to the writings different from their contents, it was left with no other course than to find that the taxable nature of the $16,500 payment consistent with her complaint was in settlement of her demand upon Mr. Murdoch to account to her for profits to which she claimed to be entitled.

It has been said that:

> "It is now well settled that the classification for tax purposes, of amounts received in settlement of litigation is to be determined by the nature and basis of the action settled. Amounts received in compromise of a claim must be considered as the same nature as the right compromised." (Footnotes omitted.) 3B Mertens, Law of Federal Income Taxation, 22.93, at 358-359 (1958).

Carter's Estate v. C. I. R., 298 F. 2d 192, 195 (8 Cir. 1962), cert. denied 370 U. S. 910 (1962); Fowler Hosiery Co., 36 T. C. 201, 223-4 (1961) aff'd 301 F. 2d 394 (7 Cir. 1962); Estate of J. T. Longino, 32 T. C. 904 (1959); Albert J. Goldsmith, 22 T. C. 1137, 1144-45 (1954); Peter K. Pappas, T. C. Memo. 1962-203, 7 C. C. H. 1962, Stand. Fed. Tax Rep. ¶7628(M). The taxpayer has the burden of proving what portion, if any, of a settlement is entitled to capital gains treatment. Carter's Estate v. C. I. R., supra at 194-5; Peter K. Pappas, supra.

A review of the record in the Tax Court satisfies us that Henrietta O. Murdoch did not sustain her burden of proof and that there is substantial evidence to sustain the judgment of the Tax Court that the $16,500 payment was tax-

able as ordinary income. Hence, the judgment of the Tax Court sought to be reviewed in case No. 14,223 will be affirmed.

PETITION FOR REVIEW BY COMMISSIONER OF INTERNAL REVENUE NO. 14,222.

In the joint return for the year 1957 by John P. Murdoch and his wife, Eleanor, the payment of $16,500, which is the subject of review in the foregoing case, No. 14,223, together with $3,582.30 for attorney's fees expended in connection with the suit of Henrietta O. Murdoch against Mr. Murdoch, was deducted as an ordinary and necessary business expense under §162(a), or in the alternative, under §212 of the Internal Revenue Code of 1954. In the Tax Court the Commissioner conceded that there should be "consistent treatment of the payment" in both cases.** The Tax Court accordingly, having found against the claim of deductibility by Mrs. Murdoch, held that Mr. Murdoch was entitled to the deduction of $16,500, based on the concession of the Commissioner, as well as the deduction of the attorney's fees, since the Commissioner had also expressed no objections to the same treatment of the fees as accorded the payment of $16,500.

The present petition for review by the Commissioner is of a "protective" nature to cover the contingency that would ensue if the Tax Court's judgment against the claim for deduction by Mrs. Murdoch were reversed. We intimate no opinion on the merits of the deductibility of the items claimed by Mr. Murdoch. The judgment of the Tax Court that he is entitled to deduct the payment of $16,500 and attorney's fees of $3,582.30, based on the concession made by the Commissioner, will be affirmed.

** The issues underlying the petitions for review in No. 14,223 and No. 14,222 were heard together both in the Tax Court and here.

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HENRIETTA O. MURDOCH, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 2a-12a)[1] are not officially reported.[2] The opinion of the court of appeals (Pet. 12-16) is not yet officially reported.

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[1] "R." references are to the appendix to Henrietta O. Murdoch's brief in the Court of Appeals.

[2] *Murdoch* v. *Commissioner*, decided August 16, 1962 (P-H Memo T.C., par. 62,196).

JURISDICTION

The judgment of the Court of Appeals was entered on June 7, 1963. (Pet. 12.) A petition for rehearing was denied on July 8, 1963. (Pet. 2.) The petition for a writ of certiorari was filed on August 5, 1963. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the court of appeals correctly held that substantial evidence supports the conclusion of the Tax Court that a portion of the amount paid in settlement of litigation covered claims for alleged loss of profits and was therefore taxable as ordinary income rather than as a capital gain.

STATUTE INVOLVED

Internal Revenue Code of 1954:

SEC. 61. GROSS INCOME DEFINED.

(a) *General Definition.*—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items;
(2) Gross income derived from business;
(3) Gains derived from dealings in property;

* * * *

(5) Rents;

* * * * *

(7) Dividends;

* * * * *

(26 U.S.C. 1958 ed., Sec. 61.)

SEC. 1221. CAPITAL ASSET DEFINED.

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

* * * * *

(26 U.S.C. 1958 ed., Sec. 1221.)

STATEMENT

Henrietta O. Murdoch and her brother-in-law, John P. Murdoch, each owned 49 per cent of the stock of John P. Murdoch Company (R. 2a-3a.) Mr. Murdoch, the president, a director, and the actual manager of their family corporation, was dissatisfied with the arrangement whereby he did all the work but Mrs. Murdoch received one-half of the profits; he told

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Henrietta inherited her 49 per cent interest upon the death of her husband, Eugene Murdoch, in September, 1945. (R. 2a-3a.)

her that unless some suitable arrangement was worked out he would "close the business." (R. 3a-4a.) Sometime shortly after September, 1945, John P. Murdoch and Mrs. Murdoch agreed that the Murdoch Company's physical assets (real estate and production equipment) would be transferred to a new corporation—the 3630 Haverford Avenue Corporation ("3630")—in exchange for the latter's stock, 49 per cent of which was to be issued to Henrietta Murdoch and the other 49 per cent to John P. Murdoch and his wife. (Pet. 12.) Upon receipt of the 3630 stock, Mrs. Murdoch transferred to John P. Murdoch her 49 per cent interest in Murdoch Company, giving him 98 per cent of that company's stock. (R. 5a.)

On December 31, 1946, 3630 leased its physical assets to Murdoch Company for $1,200 per year plus taxes and mortgage interest. This rental arrangement continued until April 1, 1955, when the rent was increased to $5,000 per year without the obligation of the lessee to pay taxes or interest. (Pet. 12.)

In June, 1955, Mrs. Murdoch instituted an equity action against Mr. Murdoch in a Pennsylvania court. She alleged, *inter alia*, that she was fraudulently induced to exchange her 49 per cent interest in Murdoch Company for the 49 per cent interest in 3630, and that the annual fair rental value of the physical assets leased by 3630 to Murdoch Company was $6,500, not $1,200. (Pet. 12-13; R. 6a-7a.) Mrs. Murdoch demanded of John P. Murdoch (Pet. 13; R. 8a):

(a) * * * an accounting of all the profits made by him by virtue of his ownership of 50% of the stock of the John P. Murdoch Company since the 1st day of January, 1945.

(b) 49% of the fair rental value of the real estate and machinery leased by the 3630 Haverford Avenue Corporation to the John P. Murdoch Company from December 31, 1946 until December 31, 1954.

(c) A complete accounting of all transactions of the John P. Murdoch Company and the 3630 Haverford Avenue Corporation from the 1st of January, 1945 to date.

(d) Such other and further relief as this court may deem appropriate in the premises.

The litigation was settled before trial, on December 11, 1957, for $36,500. Mrs. Murdoch executed two documents. One was designated a "Release" and provided for the payment to her of $16,500 in return for her release of all claims against John P. Murdoch, the Murdoch Company, and 3630. (R. 8a-9a.) The other document, designated a "Bill of Sale," provided that Mrs. Murdoch assign to Mr. Murdoch her 3630 stock in return for $20,000. Mr. Murdoch gave separate checks covering these transactions. A $16,500 check stated on its face: "Payment in release of all claims in suit of Murdoch v. Murdoch, C.P.I." The other check was for $20,000 and was marked "Payment in full for 49% shares 3630 Haverford Ave. Corp. stock." (Pet. 13-14.)

In her income tax return for 1957, Henrietta O. Murdoch reported the $36,500 ($16,500 plus $20,000) received from Mr. Murdoch as proceeds from the

sale of "John P. Murdoch Co." and the gain therefrom as long term capital gain. The Commissioner, however, determined (1) that the $16,500 payment represented ordinary income and (2) that Mr. Murdoch could not deduct it. (R. 10a, 11a.) The Tax Court upheld the Commissioner's treatment of the $16,500 as ordinary income, but held that Mr. Murdoch could deduct the amount. The court stated (R. 11a-12a):

> The Government recognizes that these determinations are inconsistent and does not seek to have both of them sustained. The real parties litigant are Henrietta and John. We sustain John's version of the transaction, with the consequence that the $16,500 payment must be treated as ordinary income to Henrietta and deductible by him.
>
> * * * *
>
> The $16,500 payment was received in compromise of Henrietta's equity suit against John. Its taxable nature must be considered in the light of the claim from which it arose. The main thrust of her complaint was an accounting from John in respect of profits to which she, somehow or other, claimed to be entitled. The $16,500 payment was in response to that claim. It was not consideration for a capital asset, and was taxable to her as ordinary income.

The court of appeals affirmed (Pet. 12-16). It held (Pet. 15-16) that there was substantial evidence to support the Tax Court's conclusion that the $16,500 payment to Mrs. Murdoch "was in settlement of her demand upon Mr. Murdoch to account to her for

profits to which she claimed to be entitled" and therefore was taxable as ordinary income.

ARGUMENT

As petitioner herself recognizes (Pet. 7-9), there is no conflict and the case presents only the narrow question whether the law was correctly applied to the facts of this case. The governing principle is clear: as both courts below correctly held (Pet. 15; R. 11a-12a), whether amounts received in settlement of a lawsuit are capital gains or ordinary income depends upon the nature and basis of the claims which are settled. *Carter's Estate* v. *Commissioner*, 298 F. 2d 192, 195 (C.A. 8), certiorari denied, 370 U.S. 910; *Sager Glove Corp.* v. *Commissioner*, 311 F. 2d 210, 211 (C.A. 7), certiorari denied, 373 U.S. 910; *Raytheon Production Corp.* v. *Commissioner*, 144 F. 2d 110, 113-114 (C.A. 1), certiorari denied, 323 U.S. 779; cf. *United States* v. *Gilmore*, 372 U.S. 39; *United States* v. *Patrick*, 372 U.S. 53; *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426. Where, as in the present case, the claim that was settled was for loss of alleged profits, the amount paid in such settlement represented compensation for the income which had been lost, and is therefore properly treated as ordinary income rather than as capital gain.

The record fully supports the Tax Court's conclusion that the $16,500 payment was made "in response to" petitioner's claim that she was entitled to "an accounting from John in respect of profits to which she * * * claimed to be entitled" (R. 11a-12a).

Petitioner's complaint in the State court charged that Mr. Murdoch had defrauded her and sought, among other things, an accounting of profits and 49 per cent of the fair rental of the Murdoch Company's physical assets (R. 7a-8a). The settlement consisted of two separate, although obviously related, transactions: the payment of $16,500 for release of all claims against the two companies and Mr. Murdoch personally, and the assignment of Mrs. Murdoch's 3630 stock in return for $20,000. Separate checks were given for each transaction. The Tax Court was justified in concluding in these circumstances, and in the absence of any contrary evidence by petitioner, that the $16,500 payment was, as the court of appeals stated (Pet. 15), "in settlement of her demand upon Mr. Murdoch to account to her for profits to which she claimed to be entitled." There is no occasion for further review of that issue.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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SEPTEMBER, 1963.

SUPREME COURT, U. S.
SEP 10 1963

IN THE

Supreme Court of the United States

October Term, 1963.

No. 339.

HENRIETTA O. MURDOCH,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit.

Reply Brief for Petitioner

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IN THE

SUPREME COURT OF THE UNITED STATES.

October Term, 1963.

No. 339.

HENRIETTA O. MURDOCH,
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v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

REPLY BRIEF FOR PETITIONER.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

1. It is not true that petitioner "recognizes there is no conflict" (Resp. p. 7).

Petitioner asserts that the case conflicts with **all** the decided cases, and that by it "well settled law" has become unsettled.

We have *no* complaint against the **facts as found** by the Tax Court and the Court of Appeals. The prayers of her complaint for an *accounting*—for financial information—were **found as a fact verbatim** by the Tax Court and the Court of Appeals.

The Tax Court *found as a fact* that the *sole* and *only gravamen* of her complaint was (6a):

> "Plaintiff's husband died in September, 1945 and thereafter the defendant, by means of false representations as to the value of the shares of the John P. Murdoch Company, received by her by the Will of her husband, fraudulently induced the plaintiff to exchange all of her shares in the John P. Murdoch Company for 49% of the shares of the 3630 Harverford Avenue Corporation which was then formed by the defendant for the purpose of defrauding the plaintiff of her rights in the John P. Murdoch Company."

> "The allegations and evidence as to the amount of profits were necessary in order to establish the value

* * * * *

* * * **'the determining factor is the nature of the basic claim** * * *" *Raytheon Production Corp. v. Comm.* (C. A. 1), 144 F. 2d 110, 113.

The "basic" and only claim is the gravamen. The prayers are for information. Perhaps her prayers were not adroitly phrased by her lawyers, but the gravamen remains. It is her basic claim. It is her only claim.

2. The examining revenue agent was right.

With all due respect for the hierarchy of the Internal Revenue Service and the Tax Division of the Department of Justice, the daily application of the law and the decisions to the raw facts is done by the Internal Revenue Agents. Here is the genesis of practically all tax cases, including the case at bar.

To the facts of this case, *consisting of the complaint and the settlement instruments*, the Agent denied the deduction of $16,500 of the $36,500 settlement to John P. Murdoch, Jr.; and this arrived in the Tax Court as Docket No. *89,551* (12a).

Later, as a protective measure, perhaps feeling that the element of predictability is ever uncertain in the law, a statutory notice was issued to Henrietta O. Murdoch, which became Tax Court Docket No. *92,922*.

The findings of fact of the Tax Court are the same as those of the Revenue Agent. It goes wrong when in its "*Opinion*" it writes about "profits to which she, *somehow or other*, claimed to be entitled." The respondent's Brief in Opposition cynically omits the critical and uncertain words **"somehow or other"** (Resp. p. 7).

She was **not** entitled to, and did **not** claim, *any profits from John P. Murdoch*. And there is **no finding of fact** that she **did** claim any profits from John P. Murdoch.

The decision in this case, being contrary to all the decided cases, is confusing to taxpayers and Revenue Agents throughout the land. Costly to the government, too.

Respectfully submitted,

HENRY D. O'CONNOR,
Attorney for Petitioner

Office-Supreme Court, U.S.
FILED
NOV 14 1963
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

October Term, 1963.

No. 339.

HENRIETTA O. MURDOCH,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit as of No. 14,223.

Petition for Rehearing

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IN THE

SUPREME COURT OF THE UNITED STATES.

October Term, 1963.

No. 339.

HENRIETTA O. MURDOCH,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT AS OF NO. 14,223.

PETITION FOR REHEARING.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The Petition of Henrietta O. Murdoch respectfully represents:

As the Court of Appeals in the case at bar writes:

> "The pith of her argument is that Mr. Murdoch fraudulently induced her to part with her stock in the Murdoch Company for an amount less than subsequent disclosure revealed the book value to be; that Mr. Murdoch, individually, owed her no duty to pay income on her interest in the Murdoch Company; that the only source to which she could look for income was the Murdoch Company by way of dividends and that she did not make the company a party to her suit."

It is not suggested anywhere that there is anything wrong with her argument.

This is what is taught in law school:

> "Even more, as they (the law schools) teach what is, the legislature, courts, and commissions are busy rescinding their dogma." Irwin Panter, Esq., of the Chicago Bar, in the *Illinois Bar Journal*, January, 1963.

Another instance that:

> "The life of the law has not been logic: it has been experience." *The Common Law*, Oliver Wendell Holmes.

A Secretary of the Navy is a co-defendant in a fraud action involving stock operations which, like *Murdoch*, is settled out of court. *Murdoch* establishes a pattern for tax

saving in the settlement of fraud cases. O Tempora! O Mores!

Like Richard the Third, John P. Murdoch, Jr., wanted the whole kingdom. Out with the nephews! For it was not the widow that John P. Murdoch, Jr., wanted out—it was her sons.

John P. Murdoch, Jr., defrauded his brother's widow in 1945 while her two sons (employed in the business founded by their grandfather, John P. Murdoch) were away in the armed forces of the United States, her son, John P. Murdoch, 3rd, being overseas.

John P. Murdoch, Jr., has no male issue.

So the widow asked for an accounting.

She never got one before settlement.

It was not until *after the conclusion of the trial* in the Tax Court that any financial information became known to her when Judge Raum ordered the income tax returns of the Murdoch Company made available to her attorney (See Record, p. 25a).

When the figures disclosed that her claim was really for $157,179.45, and was settled for $36,500.00, promptly her counsel filed a petition with the state court to set aside the settlement and to open up the case. This is still pending in the state court.

Here's a howdy do. What happens taxwise if she is successful in the state court?

The *trial* in the Tax Court was an utter waste of time. It made its findings *solely on the stipulated facts*. For example, here is part of the cross-examination of John P. Murdoch, Jr. (Record, pp. 24a-25a):

"Q. The important thing of the John P. Murdoch Company is the business. You could do that business anywhere?

A. Yes.

Q. And the neighborhood adds nothing to it, the location?

A. No.

Q. It is the name John P. Murdoch Company, that is the big thing, isn't it?

A. Yes.

Q. And that was your father's name?

A. That is right.

Q. And he started the business?

A. Yes, sir."

We are correct on the law. **All the cases,** common sense—and logic—hold that **"the nature of the basic claim"** determine the tax liability.

Our cross-examination was to the point.

The *only* way to decide against us is to write—as did the Tax Court—that *"somehow or other"* we are wrong.

What a way to run a railroad

Wherefore your petitioner prays your Honorable Court to grant a rehearing of her Petition for Certiorari.

HENRIETTA O. MURDOCH, *Petitioner.*

By: HENRY D. O'CONNOR,
Attorney for Petitioner.

CERTIFICATE OF COUNSEL.

I hereby certify that the foregoing Petition for Rehearing is presented in good faith and not for delay; also, that this Petition is restricted to the grounds above specified.

HENRY D. O'CONNOR,
Attorney for Petitioner.